



# STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

Date Amended:	06/27/07	Bill No:	<a href="#">AB 1551</a>
Tax:	Adult Entertainment Venue Tax	Author:	Calderon
	Adult Entertainment Tax		
Related Bills:			

## BILL SUMMARY

Effective January 1, 2008, this bill would impose an 8 percent tax on the gross receipts, as defined, of an adult entertainment venue, as defined, in this state. This bill also would impose an 8 percent tax on the total gross charges, as defined, incurred by a purchaser of a pay-per-view adult entertainment movie, as defined. The revenues derived from the tax would be transferred to a newly created Adult Entertainment Impact Fund.

## ANALYSIS

### ADULT ENTERTAINMENT VENUE TAX

*Revenue and Taxation Code Sections 6011 and 6012 and  
Part 14.5 (commencing with Section 33001)*

### Current Law

#### State Law

Under existing law, the sales or use tax applies to the sale or use of tangible personal property in this state, unless otherwise exempted or excluded by statute. Currently, the Sales and Use Tax Law contains no special tax provision with respect to the sale or use of tangible personal property of a sexually explicit nature. Tax applies to these sales or purchases in the same manner as it applies to sales of tangible personal property in general.

The base state and local sales and use tax rate is 7.25 percent. Of the 7.25 percent base rate, 6.25 percent is the state sales and use tax portion and 1 percent is the local sales and use tax portion. The components of the state sales and use tax rate of 6.25 percent are as follows:

- 5 percent is allocated to the state's General Fund, which is dedicated for state general purposes (Sections 6051, 6051.3, 6201, 6201.3 of the Revenue and Taxation Code (RTC));
- 0.25 percent is allocated to the Fiscal Recovery Fund which is dedicated to the repayment of the Economic Recovery Bonds (Sections 6051.5 and 6201.5 of the RTC).
- 0.5 percent is allocated to the Local Revenue Fund which is dedicated to local governments for program realignment (Sections 6051.2 and 6201.2 of the RTC);
- 0.5 percent is allocated to the Local Public Safety Fund which is dedicated to local governments to fund public safety services (Section 35 of Article XIII of the California Constitution).

*This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the Board's formal position.*

**Federal Law**

Under Title 18 United States Code (USC) Section 2257, producers of books, magazines, periodicals, films, videotapes, or other matter which contain visual depictions of actual, not simulated, sexually explicit conduct are required both to maintain records of each performer portrayed in a visual depiction of sexually explicit conduct and required to affix a statement to the product describing where the records are located. Title 18 USC Section 2257 is found under the provisions related to crimes and criminal procedure of sexual exploitation and other abuse of children.

Title 18 USC Section 2257, provides that “actual sexually explicit conduct” is defined in Title 18 USC Section 2256. Section 2256 defines “actual sexually explicit conduct” to mean:

- sexual intercourse, including genital-genital, oral-genital, anal-genital, oral-anal, whether between persons of the same or opposite sex;
- bestiality;
- masturbation;
- sadistic or masochistic abuse; or
- lascivious exhibition of the genitals or pubic area of any person.

Section 2257 requires the Attorney General to establish regulations for the enforcement of this section, and has promulgated a series of regulations found at 28 Code of Federal Regulations (CFR) Part 75. Regulation 75.8, *Location of the statement*, provides that all books, magazines, and periodicals are required to contain a statement either on the first page that appears after the front cover or on the page on which copyright information appears. With respect to any film or videotape which contains end credits for the production, direction, or distribution, the statement is to be presented at the end of the end titles or final credits and is to be displayed for a sufficient duration to be read by the average viewer. For any other film or videotape, the statement is to be presented within one minute from the start of the film or videotape, and before the opening scene, and is to be displayed for a sufficient duration to be read by the average viewer.

**Proposed Law**

This bill would add Part 14.5 (commencing with Section 33001) to Division 2 of the RTC to impose an 8 percent tax (in addition to the sales tax) on the gross receipts, as defined, of an adult entertainment venue, as defined. This bill would be known as the “Adult Entertainment Venue Tax,” and would create a new fund, the Adult Entertainment Impact Fund, and provide that the revenues derived from the tax would be transferred to this fund.

**Definition of “adult entertainment venue”**

This bill would define an “adult entertainment venue” to mean any of the following:

- 1) A retail establishment located in California whose substantial purpose is the sale or rental of adult material.
- 2) The premises of any facility located in California that provides a public or private viewing of adult material.
- 3) The public premises of any facility located in California offering live sexually explicit conduct that is prohibited to audiences under 18 years of age or 21 years of age, depending on the sale of alcoholic beverages on the premises.

---

*This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the Board's formal position.*

This bill would specify that an “adult entertainment venue” would not include:

- A retail establishment that is open to the general public and segregates adult material by restricting access to persons 18 years of age or older and whose gross receipts from transactions involving adult material do not exceed 5 percent of the retail establishment’s total gross receipts.
- A business whose primary purpose is to conduct live performances which may include the display of complete nudity, so long as the live performance is a legitimate play, opera, ballet, or concert shown at a concert house, playhouse or theater, museum, or education institution or facility whose premises may sell alcoholic beverages but derives less than 20 percent of its total gross receipts from the sale of alcoholic beverages.

Definition of “adult material”

This bill would define “adult material” to include all of the following:

- Harmful matter, as defined in Section 313 of the Penal Code. Section 313 defines “harmful matter” as matter, which to the average person, applying contemporary statewide standards, appeals to the prurient interest and is matter that depicts or describes in a patently offensive way sexual conduct. Such matter also lack serious literary, artistic, political, or scientific valued for minors.

“Matter,” under Penal Code Section 313, is defined as any book, magazine, newspaper, video, or other printed or written material such as any picture, drawing, or photograph. “Matter” also includes any statue or other figure, motion picture, or any mechanical, chemical, or electrical reproduction, or any other articles, equipment, machines, or materials.

- Live sexually explicit conduct provided at a business establishment.
- Any item that includes sexually explicit conduct or is subject to the requirements of Section 2257 of Title 18 of the United States Code.

This bill defines “sexually explicit conduct” to mean any of the following actual, but not simulated, conduct:

- 1) sexual intercourse, including genital-genital, oral-genital, anal-genital, oral-anal, whether between persons of the same or opposite sex;
- 2) masturbation;
- 3) sadistic or masochistic abuse; or
- 4) lascivious exhibition of the genitals or pubic area of any person.

This bill defines “gross receipts” to include receipts from whatever source, received by the adult entertainment venue, except would not include sales taxes imposed on the transaction.

This bill would also provide that any determinations, collections of tax, overpayments and refunds, and administration required under the provisions of this bill would be governed pursuant to Chapters 5, 6, 7, and 8 of Part 1 of the Sales and Use Tax Law.

The Board would be required to enforce the provisions of this bill and may prescribe, adopt, and enforce rules and regulations relating to the administration and enforcement of this bill.

This bill would provide that the revenues derived from the tax, less refunds and the Board's administrative costs, would be deposited into the Adult Entertainment Impact Fund, which this bill creates.

As a tax levy, the bill would become effective immediately upon enactment. However, the provisions of this bill would be operative on or after January 1, 2008.

### Background

**AB 1999 (Torrico, 2006)** would have imposed an additional 1 percent tax, administered by the Board, on sales and purchases of "harmful matter," as defined. This bill was never heard in a committee.

**AB 1301 (Washington, 1999)** would have required the California Health and Human Services Agency to conduct a study to determine whether there is any connection between pornography and sexual abuse, and to report its findings to the Legislature by August 31, 2000. This bill would have also required the Board to make recommendations to the Legislature, by August 31, 2000, regarding an appropriate method to impose a tax on pornography. This bill was never heard in a committee.

**SB 1013 (Calderon, et al., 1997)** would have added a 5 percent tax, administered by the Board, to the sale of sexually explicit pornographic materials or services, as defined. This bill failed passage in the Senate Revenue and Taxation Committee.

### COMMENTS

1. **Sponsor and purpose.** This bill is sponsored by the author and is intended to provide funding to ameliorate the negative secondary effects of adult entertainment venues.
2. **What is an adult entertainment venue?** This bill defines three categories of adult entertainment venues which would be subject to the tax:

- A retail establishment located in California whose substantial purpose is the sale or rental of adult material. A retail establishment meeting this description would be an adult store. Under the provisions of this bill, all of the adult store's gross receipts would be subject to the additional tax. That is, tax would apply to sales of all items, including, but not limited to sales of videotapes, DVDs, books, magazines, pictures, lingerie, oils, lotions, statues, and sexual devices or toys.

As currently written, it appears that the Board would be responsible for determining what constitutes *substantial purpose*. In general, the Board has determined *substantial purpose* to mean 80 percent or more. Is it the author's intent that an adult entertainment venue means a retail establishment whose sales or rentals of adult material represent 80 percent or more of the establishment's gross receipts?

- A facility located in California that provides a public or private viewing of adult material. A business establishment meeting this description would be an adult arcade or adult motion picture theater. Under the provisions of this bill, all of the adult arcade or theater's gross receipts would be subject to the additional tax. This includes receipts from the sale of tickets, food items, drinks, and other tangible personal property sold by the adult arcade or theater.
- The public premise of any facility located in California offering live sexually explicit conduct that is prohibited to audiences under 18 years of age or 21 years of age, depending on whether alcoholic beverages are sold on the premises. A

---

*This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the Board's formal position.*

business establishment meeting this description would be an adult cabaret, nightclub, strip bar, or theater offering live entertainment. All of the adult establishment's gross receipts would be subject to the additional tax. This would include receipts from the sale of food, beverages or other items sold by the adult establishment as well as any charges for the performance.

An adult entertainment venue would not be:

Convenience stores and liquor stores that make sales of "adult material" magazines would not be considered an adult entertainment venue under the provisions of this bill, as their gross receipts from sales of adult material magazines would more than likely be less than 5 percent of the store's total gross receipts. Similarly, certain novelty stores that sell "adult material" products, would not be classified as adult entertainment venues as any receipts from these sales would more than likely be less than 5 percent of the store's total gross receipts.

Live performances with displays of complete nudity where the performance is considered a legitimate play, opera, ballet, or concert (e.g., Hair) would not be considered an adult entertainment venue.

3. **Some sales and rentals of adult materials at adult stores may not be considered substantial, and thus, would not be subject to the additional tax.** This bill provides that an adult entertainment venue means a retail establishment located in California with a substantial purpose of selling or renting adult materials. In general the Board has determined *substantial* to mean 80 percent or more. In applying this rule to an adult store's sales, if 80 percent or more of an adult store's gross receipts are from the sales or rentals of adult materials, then the store would be considered an adult entertainment venue and its gross receipts from the sale of all items would be subject to the additional tax.

However, Board staff notes that some adult stores may not meet the 80 percent threshold. Some adult stores sell a number of items that would not be considered adult materials, such as, lingerie, lotions, oils, novelties (e.g. coffee mugs, glasses, figurines, key chains, etc.), and sexual devices and toys. In addition, for those adult stores whose sales of adult materials are close to the 80 percent threshold, the bill could create an incentive for the retailers to stock more items which would not be considered adult materials in an effort to avoid collecting the additional tax. Consequently, the anticipated revenues associated with the proposed tax increase, with respect to adult stores, may not be realized.

4. **Adult materials purchased via the Internet or mail order from out-of-state sellers would not be subject to the proposed tax.** Many purchasers prefer to purchase adult materials via the Internet or mail order because they can do so privately and anonymously. Thus, the proposed tax increase could provide further incentive to acquire these items from out-of-state sellers, in an effort to avoid the tax. This would create a competitive disadvantage for California adult entertainment businesses.

In addition, purchasers acquiring adult materials from out-of-state sellers to avoid the proposed tax might also fail to report the use tax due on these purchases. The Board's collection of use tax relies heavily on the voluntary compliance of purchasers of tangible personal property. However, due to the general misconception that purchases from outside this state are "tax free" and the insufficient audit resources to pursue all purchasers, the voluntary compliance rate is

very low. The tax increase proposed in this bill could intensify noncompliance by the purchasers in reporting their use tax obligations on their out-of-state Internet or mail order purchases of adult material.

5. **Determining what items qualify as “harmful matter” would be very difficult to administer and perhaps beyond the scope of the Board.** Examining an item to see if it shows sexually explicit conduct or has a federal disclosure statement would pose less difficulty for Board staff, but would still have problems.

“Harmful matter.” “Harmful matter” is defined as matter, taken as a whole, which to the average person, applying contemporary statewide standards, appeals to the prurient interest and depicts or describes in a patently offensive way sexual conduct. Because the definition is extremely subjective in nature, it creates difficulty in determining when such item qualifies as a “harmful matter.”

Moreover, Board staff notes that often a court test is needed to determine if matter is harmful. We note that the definition of “obscene matter” under Penal Code section 311 is almost identical to the definition of “harmful matter” under Penal Code section 313 and is based on the standards provided by the U.S. Supreme Court in *Miller v. California* (1973) 413 U.S. 15, who struggled for some time in establishing a test for obscenity, causing it to review each case ad hoc. Under *Miller v. California* (1973) 413 U.S. 15, as applied in a later case *Jenkins v. Georgia* (1974) 418 U.S. 153, 161, the U.S. Supreme Court justices had to personally review the allegedly obscene material, even to the point of actually watching an allegedly obscene movie.

Adult material showing sexually explicit conduct or subject to disclosure statement. Adult material also includes material showing sexually explicit conduct. Even though the definition of sexually explicit conduct is more defined than “harmful matter,” determining what items qualify (books, magazines, statues, sex toys, videos) could be very difficult and perhaps beyond the scope of the Board. Perhaps the Department of Justice could provide a list of such qualifying items.

With respect to items subject to the requirements of Section 2257, this provision more clearly defines items which would be subject to the tax. This provision would also eliminate the Board’s need to evaluate an item for its content; if the magazine or video contains the federally-required disclosure statement, it qualifies as adult material. However, if the author intends for adult material to include certain statues and sex toys, these items are not subject to the Section 2257 requirements. In addition, Board staff can examine a magazine or video to see if the item bears the disclosure statement. But, what if a magazine or video does not contain a statement? Perhaps the bill should provide that any item carrying a federally-required disclosure statement pursuant to the requirements of Section 2257.

6. **Impact on adult entertainment stores.** It is important that these stores periodically test their sales of merchandise to determine if their gross receipts are substantially attributable to the sale of adult materials and subject to the tax. When a store changes its product mix, it should perform a test to determine whether the store is an adult entertainment venue and subject to the tax.
7. **Administrative and technical amendments.** The bill has several administrative and technical issues that would need to be addressed before the bill becomes law. Some of the amendments include:
  - Section 33005 provides that the provisions related to determinations, collections

---

*This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the Board’s formal position.*

of tax, overpayments and refunds, and administration would be, to the extent feasible, governed under Part 1 of Division 2 of the Sales and Use Tax Law. Since this tax is not a sales and use tax, it is recommended that the administrative provisions be placed under the Fee Collections Procedures Law (Part 30, Division 2 of the RTC).

- Subdivision (a)(2) of Section 33003 provides that an adult entertainment venue does not include a retail establishment with sales of adult material for which the gross receipts from those sales does not exceed 5 percent of the establishment's total gross receipts. What if a retail establishment's gross receipts from sales of adult materials are 10 or 20 percent of its total gross receipts? An adult entertainment venue is defined as a retail establishment located in California with a substantial purpose (i.e., 80 percent) that is the sale or rental of adult material. There appears to be a conflict between the provisions that define an adult entertainment venue.

Staff will work with the author's office to address these issues as the bill progresses through the legislative process.

8. **Bill should have a delayed operative date.** The bill provides for an operative date of January 1, 2008. However, the Board would need at least a six-month lead time from the effective date of the bill to perform the various tasks such as programming, identifying and notifying affected adult entertainment venues, modifying or creating a new tax return, and more. The language should specify that the tax would go into effect on the first day of the first calendar quarter commencing at least six months following the bill's effective date.
9. **This bill provides for reimbursement of the Board's administrative costs.** This bill provides that the Board would transmit all payments attributable to the adult entertainment venue tax, less refunds and the Board's costs of administration, to the deposit of the Adult Entertainment Impact Fund, which this bill creates.
10. **First amendment issues.** Applying the proposed tax to certain "adult entertainment venues" might trigger first amendment protection. As the U.S. Supreme Court explained in *Arkansas Writers' Project, Inc. v. Ragland* (1987) 481 U.S. 221, a state may not levy a sales tax on certain types of magazines based on the content of those magazines. Arkansas had imposed a tax on general interest magazines, but had exempted newspapers and religious, professional, trade, and sports journals. The court found that since the tax would be "content-based," a heightened scrutiny under the First Amendment would be triggered.

In addition, Board staff notes that certain broad-based attempts at both the federal and state level have failed, due in no small part to concerns that the proposed laws would not pass constitutional muster. The Internet Safety and Child Protection Act of 2005 (Sen. No. 1507, 109<sup>th</sup> Cong., 1<sup>st</sup> Sess.) would have: 1) set tighter age verification standards to block minors from entering Internet pornography sites; and 2) provide funding and support to law enforcement efforts to combat Internet and pornography-related crimes against children. The Adult Entertainment Tax Act of 2004 (Mo. Sen. Bill No. 0821, 92<sup>nd</sup> Gen. Assem., 2<sup>nd</sup> Reg. Sess.) would have taxed adult entertainment products and services including matter containing sexually explicit material, or live performances of sexually explicit conduct.

11. **Other states.** The state of Utah has enacted a 10 percent excise tax related to sexually explicit businesses (see Utah Code Annotated, §§59-27-101 through 59-27-

---

*This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the Board's formal position.*

108). This “Sexually Explicit Business and Escort Service Tax” became effective on July 1, 2004, and has been subject to court challenge. Utah’s tax is imposed on transactions conducted by a sexually explicit business or escort service (i.e., admission fees, user fees, any services, sales of food, beverages, and other tangible personal property). The revenue generated from this tax is deposited into a special fund for various treatment programs and task forces dealing with sexual offenders.

The case, *TDM Inc. et al. v. Tax Commission et al.*, has been filed in Utah’s state district court. The issue is whether the state’s sexually explicit business and escort service tax law, which imposes a tax “equal to 10 percent of amounts paid to, or charged by sexually explicit businesses,” violates the First Amendment of the U.S. Constitution.

According to Utah’s Attorney General’s Office, the case was heard on June 4, 2007. On June 5, 2007, the judge verbally ruled in favor of the Utah Tax Commission finding the tax to be constitutional and not in violation of first amendment. However, a written signed order has not yet been entered.

### **ADULT ENTERTAINMENT TAX**

#### *Revenue and Taxation Code Part 14.7 (commencing with Section 33100)*

#### **Current Law**

Under existing law, there is no state-imposed tax or fee on pay-per-view movies, including adult movies, delivered by a cable provider, hotel owner or operator, or satellite television provider.

Under existing law, cable service in California is subject to direct local taxation based on the rationale of the use of public rights-of-way and being granted a local monopoly. Cable service is regulated by the federal government and the State of California, and is subject to a regulatory fee levied by the Federal Communications Commission (FCC). In California, two principal fees and charges are levied on cable television connections:

- Franchise fees--these are paid to local governments by privately-owned cable companies for the privilege of using local government property and rights-of-way. Federal law prohibits franchise fees from exceeding 5 percent of gross receipts, while state law also limits franchise fees to a percentage of gross receipts. State and federal law also prevents companies from providing cable services without acquiring a franchise. California has delegated to cities and counties the franchising authority over cable companies, whose fee payments represent a general fund revenue source.
- Utility-user tax--this is a gross proceeds tax levied by some local governments on cable television services, and other utilities such as telephone, gas, and electric services. Tax rates generally range from 5 percent to 7 percent and represent a general fund revenue source for local governments.

Existing law, Section 637.5 of the Penal Code, prohibits a satellite or cable television corporation from providing individual subscriber information available to government agencies in the absence of legal compulsion, including, but not limited to a court order or subpoena. If requests for information are made, a satellite or cable television corporation must promptly notify the subscriber of the nature of the request and what government agency has requested the information prior to responding, unless otherwise prohibited by law to do so.

---

*This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the Board’s formal position.*

**Proposed Law**

This bill would add Part 14.7 (commencing with Section 33100) to Division 2 of the RTC to impose an 8 percent tax on the total gross charges that are incurred by a purchaser of a pay-per-view adult entertainment movie in this state. This bill would require that the tax imposed by this part be collected from a purchaser by a cable provider, hotel owner or operator, or satellite television provider to the extent permitted by state or federal law.

The bill would provide the following definitions:

- “Adult entertainment movie” would mean any motion picture that is subject to the requirements of Section 2257 of Title 18 of the USC. “Adult entertainment movie” would not include a motion picture that does not depict either nudity or sexually explicit conduct in a public place or unprotected sexual activity.
- “Cable provider” would mean the person or entity providing cable television services through the cable television system.
- “Satellite television provider” would mean the person or entity providing satellite television services through a satellite broadcasting system.
- “Hotel owner or operator” would mean the person or entity that owns and operates any hotel, motel, bed and breakfast inn, or other similar transient lodging establishment.
- “Pay-per-view” would mean a delivery by a cable provider, hotel owner or operator, or satellite television provider of a single program or a specified group of programs, for which a single program is generally uninterrupted by commercial advertising messages and for which recipients are charged a separate fee for each program or specified group of programs. “Pay-per-view” also includes delivery of a single program for which multiple start times are made available at time intervals which are less than the running time of the whole program.
- “Total gross charges” would mean all charges imposed on the purchaser related to the transmission of a pay-per-view adult entertainment movie.
- “Nudity” would mean the showing of the human male or female genitals, pubic area, or buttocks with less than a fully opaque covering.
- “Unprotected sexual activity” would mean sexual activity without the use of a condom or other visible form of protection against sexually transmitted diseases.
- “Sexually explicit conduct” would mean any of the following actual, but not simulated, conduct:
  - 1) Sexual intercourse, including genital-genital, oral-genital, anal-genital, or oral-anal, whether between persons of the same or opposite sex.
  - 2) Masturbation.
  - 3) Sadistic or masochistic abuse.
  - 4) Lascivious exhibition of the genitals or pubic area or any person.

This bill would also provide that any determinations, collections of tax, overpayments and refunds, and administration required under the provisions of this bill would be governed pursuant to Chapters 5, 6, 7, and 8 of Part 1 of the Sales and Use Tax Law.

The Board would be required to enforce the provisions of this bill and may prescribe, adopt, and enforce rules and regulations relating to the administration and enforcement of this bill.

This bill would provide that the revenues derived from the tax, less refunds and the Board's administrative costs, would be deposited into the Adult Entertainment Impact Fund, which this bill creates.

As a tax levy, the bill would become effective immediately upon enactment. However, the provisions of this bill would be operative on or after January 1, 2008.

## COMMENTS

1. **Purpose.** This provision is intended to provide funding to ameliorate the negative secondary effects of 1) nudity and sexually explicit conduct in public places and 2) unprotected sex.
2. **The provision requiring a purchaser to pay the tax directly to the Board if the tax has not been collected by the hotel owner or operator, cable provider, or satellite television provider would be extremely difficult to enforce.** Under the provisions of the bill, if the tax is not collected by the hotel owner or operator, cable provider, or satellite television provider, the purchaser is required to pay the tax directly to the Board. The bill also provides that the hotel owner or operator, cable provider, or satellite television provider is required to collect the tax from the purchaser to the extent permitted by state or federal law. Thus, the payment of the tax would fall on the purchaser of the pay-per-view adult entertainment movie, should the hotel owner or operator, cable provider, or satellite television provider be prohibited under law from collecting it.

Board staff is not certain of the impact of state or federal law on a hotel owner or operator, cable provider, or satellite television provider's ability to collect the proposed tax. With respect to cable providers, both federal and state law limit franchise fees to a percentage of gross receipts. However, Board staff is not certain what affect the proposed tax would have on such fees.

In addition, state law, prohibits cable providers and satellite television providers from disclosing individual subscriber information to government agencies, in the absence of a court order. Consequently, the Board will not have information on purchases of pay-per-view adult entertainment movies. The proposed tax, similar to the Board's use tax program, will rely largely on the voluntary compliance of the purchaser of an adult entertainment movie. It should be noted that the Board's voluntary compliance rate with respect to the reporting of use tax on purchases from out-of-state retailers has been low. In addition, due to the sensitivity of the subject matter, purchasers of pay-per-view adult entertainment movies might be reluctant to come forward and report the tax due on such purchases.

3. **Definition of adult entertainment movie.** The bill defines an adult entertainment movie as any motion picture that is subject to the requirements of Section 2257 of Title 18 of the USC. The bill also provides that an adult entertainment movie would not include a motion picture that does not depict either nudity or sexually explicit conduct in a public place or unprotected sexual activity.

We note that the federally-required disclosure statement is contained within the first minute, before the first scene, or during the closing credits of the film. It would seem that any viewing of a film to identify disclosure statement or to evaluate the content of the film may not be feasible for the hotel owner or operator, cable provider, or satellite provider.

4. **Bill should have a delayed operative date.** Since the bill is imposing a new tax

---

*This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the Board's formal position.*

on a group of taxpayers that are generally not already registered with the Board, it is suggested that the Board be given a minimum lead time of 6 months to implement the proposed adult entertainment tax.

5. **Administrative and technical amendments.** The bill has several administrative and technical issues that would need to be addressed before the bill becomes law. One concern involves Section 33105 and the provisions related to determinations, collections of tax, overpayments and refunds, and administration would be, to the extent feasible, governed under Part 1 of Division 2 of the Sales and Use Tax Law. Since this tax does not parallel the sales and use tax, it is recommended that the administrative provisions be placed under the Fee Collections Procedures Law (Part 30, Division 2 of the RTC).

Staff will work with the author's office to address these issues as the bill progresses through the legislative process.

## **COST ESTIMATE**

The Board would incur substantial costs to administer this bill. These costs would be attributable to, among other things, identifying and notifying taxpayers, developing regulations, revising manuals and publications, modifying the tax return including the design of a new schedule or worksheet or creating a new tax return, computer programming, training staff, answering numerous inquiries from the public.

This bill provides that a portion of the revenues generated from the new tax would pay for the Board's costs of administration. A detailed cost estimate is pending.

## **REVENUE ESTIMATE**

### **Background, Methodology, and Assumptions**

The bill defines *adult entertainment venue* as a retail establishment located in California with a substantial purpose that is the sale or rental of adult material, the premises of any facility located in California that provides a public or private viewing of adult material, or the public premises of any facility located in California that offers live sexually explicit conduct that is prohibited to audiences under 18 years of age or 21 years of age, depending on the sale of alcoholic beverages on the premises.

*Adult entertainment movie* is defined as any motion picture that is subject to the requirements of Section 2257 of Title 18 of the USC. It does not include a motion picture that does not depict either nudity or sexually explicit conduct in a public place or unprotected sexual activity. *Pay-per-view* is defined as a delivery by a hotel owner or operator, cable provider, or satellite television provider of a single program or a specified group of programs, as to which each such single program is generally uninterrupted by commercial advertising messages and for which recipients are charged a separate fee for each program or specified group of programs. *Pay-per-view* would also include delivery of a single program for which multiple start times are made available at time intervals which are less than the running time of such programs as a whole.

We used the Adult Video News (AVN) as the primary source for adult entertainment industry sales or statistics. We also used the Free Speech Coalition, an industry trade association, which referenced AVN's data in its annual industry reports.

The AVN estimated that the US adult entertainment industry generated \$12.9 billion in 2006. Adult movies remained the largest sector at \$3.6 billion of the adult entertainment market. The following is a breakdown:

**US Adult Industry Revenue Segments in 2006**

<b>Segment</b>	<b>Sales \$</b>
Video Sales Rental	3,622,000,000
Magazines	950,000,000
Novelties	1,725,000,000
Exotic Dance Club	2,000,000,000
Cable/PPV (TV)	1,745,000,000
Mobile	39,000,000
Internet	2,841,000,000
Total	12,922,000,000

**California Adult Entertainment Industry**

**Video Sales and Rental.** The Free Speech Coalition, in a 2006 industry report, indicated that during 2005 adult and mainstream video stores in the U.S reported a total of 957 million rentals of adult tapes and DVDs, almost all of which were produced in California. Further, it noted that AVN reported in 2003 that nearly 130 million of those rentals took place in California.

To give us an idea about California's market share based on the above statistic, it is estimated that California's share would be 14% (130 million rentals / 957 million rentals = 14%). We estimate that adult video sales and rental revenues for stores in California in 2006 amounted to \$507 million (14% × \$3.622 billion = \$507 million).

Tax revenue is estimated to be \$40.6 million (\$507 million × 8% = \$40.6 million).

**Magazines.** Magazines are either sold by subscription (delivered by mail or common carrier) or at retail establishments. Based on the definition of *adult entertainment venue*, it is assumed that the proposed tax would only apply to magazines sold at retail establishments and not subscription sales. Based on a previous analysis of the magazine industry, we estimate 60% of adult entertainment magazines sales are via subscriptions.

Based on California's population, we estimate that the total adult magazine sales in 2006 was \$114 million (12% × \$950 million = \$114 million).

Tax revenue is estimated to be \$3.6 million ((\$114 million × 40%) × 8% = \$3.6 million).

**Novelties.** Based on California's population, novelties revenue for California are estimated to be \$207 million (12% × \$1.725 billion = \$207 million).

Tax revenue is estimated to be \$16.6 million (\$207 million × 8% = \$16.6 million).

**Exotic Dance Clubs.** Based on California's population, exotic dance club revenues for California are estimated to be \$240 million (12% × \$2 billion = \$240 million).

Tax revenue is estimated to be \$19.2 million (\$240 million × 8% = \$19.2 million).

**Pay Per View Movies.** AVN estimated that the adult pay per view segment (home and hotel TV movies) in 2006 represented \$1.745 billion in revenues. Based on California's

---

*This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the Board's formal position.*

population, revenues for California are estimated to be \$209.4 million ( $12\% \times \$1.745 \text{ billion} = \$209.4 \text{ million}$ ).

Tax revenue is estimated to be \$16.8 million ( $\$209.4 \text{ million} \times 8\% = \$16.8 \text{ million}$ ).

**Adult Movie Theatres.** In our conversations with one trade organization, and from an internet survey of adult theatres in Sacramento, San Francisco and Los Angeles, we found that there are very few adult movie theatres in California at present. We assume minimal revenue impact.

### **Estimated Total Tax Revenue**

Total tax revenue is estimated to be \$96.8 million

### **Revenue Summary**

This bill would generate an estimated \$96.8 million in revenues annually. The following is a breakdown:

	Revenues	Tax Rate	Revenue
	(millions)		(millions)
Video DVD Sales Rental	\$ 507	8%	\$ 40.6
Magazines	45.6	8%	3.6
Novelties	207	8%	16.6
Exotic Dance Club	240	8%	19.2
Pay Per View	<u>209.4</u>		<u>16.8</u>
Total	\$1,209.0		\$ 96.8

### **Qualifying Remark**

The industry segment revenues used for this revenue estimate reflects sales by all establishments. This bill exempts establishments whose gross receipts in relation to adult material sales do not exceed 5%. We do not know how much of these revenues would reflect such establishments.

Analysis prepared by:	Debra Waltz	916-324-1890	07/02/07
Revenue estimate by:	Bill Benson	916-445-0840	
Contact:	Margaret S. Shedd	916-322-2376	
Is			

1551-1dw.doc

*This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the Board's formal position.*